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SUBJECT: INDONESIA'S SUBSIDIES ARE A HARD HABIT TO BREAK

¶1. (SBU) Indonesia has found it politically difficult to wean itself from consumer energy subsidies. Indonesia lifted all subsidies for fuel consumed by business and industry in 2005, but government plans to do the same for consumer fuels have not been implemented. Energy subsidies routinely exceed the central government's combined expenditures on health and welfare.

¶2. (SBU) Indonesians recognize that energy subsidies disproportionally benefit wealthier Indonesians. Most analysts - from government, academia, or the press - publicly acknowledge that subsidies should be better targeted to benefit the poor. However, the government has been unwilling to make the hard choices to change the system. Reducing subsidies would require political rather than economic capital, as cost savings would be a net benefit, even if the government implemented assistance programs to poor Indonesians negatively affected by the removal of subsidies.

Subsidy Structure

¶3. (U) Indonesia's subsidies operate as fixed prices for consumers, with the government reimbursing the distributors (Pertamina for fuel, PLN for electricity) for the difference between production cost and sales price. The government subsidizes gasoline, diesel, and kerosene for individual consumers, but the commercial market for these fuels is unsubsidized and open to competition. All electricity is subsidized, although there is a sliding price scale between individual consumers and commercial users. In 2009, the government spent Rp 52.4 trillion ($5.7 billion) for fuel subsidies and Rp 47.5 trillion ($5.2 billion) for electricity subsidies, and has budgeted Rp 68.7 trillion ($7.5 billion) for fuel and Rp 37.8 trillion ($4.1 billion) for electricity in 2010.

¶4. (U) The greatest subsidy is for kerosene, which is used primarily as a cooking fuel. The government has been gradually weaning Indonesians off kerosene through a program that provides free LPG cookstoves to Indonesians. Between 2007 and December 2009, the program was successfully completed in Banten, Jakarta, West Java, Yogyakarta and South Sumatra, and is now being implemented nationally. The Indonesian government subsidizes LPG, but this subsidy is far below that for kerosene. As an added benefit, LPG emits fewer harmful emissions or greenhouse gases.

¶5. (SBU) In May 2008, when rapidly rising petroleum costs threatened to break Indonesia's budget, the government raised the subsidized fuel price from Rp 4,500 per liter ($0.49) to Rp 6,000 ($0.65), a move that immediately and significantly reduced the President's popularity. As the price of oil declined in late 2008 and early 2009, Indonesia decreased the subsidized price in stages to Rp 4,500. At that time, the government declared that the price of gasoline and diesel would no longer be subsidized and would vary with the international oil price, up to a maximum Rp 6,000 per

liter. However, the government did not change the Rp 4,500 fuel price, despite subsequent increases in the price of crude oil. Even after President Yudhoyono's victory in July 2009 elections, with 60% of the vote and oil prices increasing, the government did not raise fuel prices. In January 2010, Coordinating Minister for the Economy declared that fuel prices would not rise in 2010. Prices for fuel are standard throughout the country, and Pertamina cross-subsidizes distribution costs, although these expenses do not appear on budget for subsidies.

¶6. (SBU) Indonesia's electricity subsidies do not subsidize fossil fuels directly, although government budget pressures have pushed PLN, the national electricity monopoly, to focus on the least-cost primary energy, which currently is coal. In the outer islands, Indonesia generates much of its electricity with diesel generators, a legacy from when Indonesia was an oil exporter and could satisfy its fuel needs with domestic refining. Since fall 2009, the government has proposed several schemes to begin raising rates on targeted groups. It proposed increasing tariffs in Java and reducing them in regions that have low electricity penetration; raising tariffs in high-income neighborhoods; raising tariffs on high-income households; and finally raising tariffs on high-use households. Each proposal has been dropped soon after it was proposed. The cost of electricity generation and distribution varies widely throughout the country, from around 8.5 cents per kWh in Java to 20-30 cents per kWh in the outer islands.

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